BEFORE THE ILLINOIS COMMERCE COMMISSION
STATE OF ILLINOIS

Central Illinois Public Service Company,	)	
d/b/a AmerenCIPS, and	)	
Union Electric Company,	)	Docket Nos. 02-0798, 03-0008 and 03-0009
d/b/a AmerenUE,	)	(Consolidated)
Proposed General Increase in Natural Gas	)	
Rates (Tariffs Filed November 2002)	)	

REPLY BRIEF OF THE AMEREN COMPANIES

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Central Illinois Public Service Company ("AmerenCIPS") and Union Electric Company ("AmerenUE") (jointly, the "Ameren Companies" or "Companies" or "Ameren")[1] submit this Reply Brief in support of their respective proposed rate increases. Background; Procedural History; Nature of Operations; Test Year.

A. Procedural History

B. Nature of Operations

C. Reasons for Increase

D. Test Year

II. Rate Base

A. Introduction

B. Uncontested Issues

C. Contested Issues

1. Post-Test Year Capital Additions

The Ameren Companies believe that in their Initial Brief they have adequately addressed the AG's adjustment to plant in service to remove the post-test year known and measurable additions to plant-in-service. The Ameren Companies wish to emphasize that the Commission's

[1] Unless otherwise noted, the abbreviations used herein are the same as those used in the Ameren Companies' Initial Brief.

rule does not require the reflection of an adjustment to accumulated depreciation, nor, to our knowledge, has the Commission ever required such an adjustment. The only case the AG can cite is one in which the utility voluntarily proposed to reflect an adjustment to the reserve for accumulated depreciation. That is not an adjustment that the Ameren Companies have chosen to make, because they do not believe that it is appropriate in the context of an historical test year. AmerenCIPS/UE Ex. 27.0, p.3. Regardless, there is nothing in the rule or the case law to indicate that it is required.

To the contrary, in the Final Order in *Commonwealth Edison Company*, Docket No. 02-0423 (March 28, 2003), the Commission rejected the very adjustment that the AG has proposed here. In *Commonwealth Edison*, the utility adjusted the 2000 historical test year by including known and measurable additions to distribution plant that were in service as of June 30, 2001. The AG was a party to that proceeding, and offered the testimony of David Effron, the same witness who testified on behalf of the AG with respect to plant additions in this proceeding. In the *Commonwealth Edison* case, neither the AG, Staff nor any other party contended that the plant additions should not be included in the test year. However, the AG's witness proposed that if the plant additions through June 30, 2001, were going to be included in the test year, it was necessary to reflect the increase in depreciation of other plant for the period from the end of the test year through June 30, 2001, to avoid distortion of the revenue requirements calculation. ComEd had offered two reasons for rejecting the proposal, including that the effect of the proposed adjustment to update depreciation after the test year "would be improperly to shift the test year to the year ending on June 30, 2001, just for the accumulated depreciation reserve." (Order, p. 45.) The Commission included the plant additions in the historical test year, but rejected the AG's proposal to include post-test year depreciation in the test year, stating that the "proposed depreciation reserve adjustment is flawed for the reasons stated in ComEd's Response above." (Order, p. 45.)

The Commission should not endorse the AG's effort to shift the test year for a single item in this case, either. The AG's adjustment should be rejected.

The AG's adjustment is particularly disturbing with respect to AmerenUE. As discussed by Ameren witness Davis, AmerenUE is engaged in a substantial upgrade of its system. As a result, AmerenUE adjusted the test year to include net plant additions of $2.258 million, a figure several times greater than its annual depreciation expense. The AG, however, wants the Commission to freeze AmerenUE's rate base at December 31, 2002, to reflect net plant in-service as of that date.

There is no basis for freezing AmerenUE's net plant in-service as of December 31, 2002. The Commission's Rule expressly allows AmerenUE to adjust plant in-service for additions occurring within 12-months of the filing of the tariffs in this case; the AG's adjustment, in contrast, would simply adjust plant in-service to its net level roughly 30 days after filing. The rule does not support such an arbitrary limitation.

Moreover, the arbitrary snapshot of plant in-service at year-end 2002 is irrelevant. Under the rule, AmerenUE must place its new projects in service by late November 2003, 12 months after its late November 2002 filing. No party questioned whether the projects would in fact be in service by the deadline. What specific level of projects had been placed in service by December 31, 2002, is, thus, irrelevant.

If AmerenUE, which is engaged in the massive capital improvement program described by Mr. Davis, is unable to reflect its post-test year plant additions is rate basis, then no utility can. The dollar value of the projects dwarfs the annual depreciation expense (and, was we have noted, the Commission does not require the adjustment of the entire depreciation reserve in an historical test year in any event).

2. Cash Working Capital Allowance

Staff and the AG oppose the reflection of a separate revenue lag for PGA costs. For all the reasons discussed in the Companies' Initial Brief (pp. 14-18), recognition of a separate lag is appropriate. Moreover, as also discussed in the Initial Brief (p. 17-18), even if the Commission determines that a separate PGA lag is not appropriate, each of the Companies still has a positive cash working capital requirement, approximately \$4.4 million for AmerenCIPS and \$.5 million for AmerenUE.

In addition, the Staff continues to argue that there are significant flaws in the Companies' analyses that render it unreliable for ratemaking purposes. Specifically, the Staff argues that there are problems related to: expense leads for fuel costs; the application of "mid-point" and "obligation date" theories; and the role of Ameren Services as payment agent for the Ameren Companies. (Staff Init. Br., pp. 13-15.)

The last of these relates to consistency of lead times for AmerenCIPS and AmerenUE for similar expense items, and is easily addressed. As explained in the Companies' Initial Brief (pp. 20-22), the studies performed by Mr. Subbakrishna reflect different lead times for expenses for the two companies because the two companies have different vendors or suppliers for the expenses. While assuming that the same vendors will impose different payment terms on the two companies for natural gas (see the following discussion on fuel expense), the Staff assumes that different providers will impose identical payment terms on the two Companies.

Or it may be that the Staff assumes that, because the two Companies use the same payment agent, Ameren Services, the two companies will pay their bills the same number of days after invoicing, regardless of what the payment terms are. There is no basis for concluding that Ameren Services is or should be in the habit of doing so. The payment terms should drive the date of payment, not some need for meaningless consistency between the two companies. If payments are due under AmerenCIPS' pension plan 10 days after invoicing, and under AmerenUE's plan 15 days after invoicing, the Ameren Services should not be making payments on the same date after invoicing for the two Companies. There is no reason that Ameren Services should pay the AmerenUE bill early, which would have the effect of *increasing* AmerenUE's cash working capital requirement.

Staff also is troubled by two assumptions that Mr. Subbakrishna made in his analysis. The first relates to Mr. Subbakrishna's use of certain invoices to determine expense leads for fuel expense. In particular, the Staff was troubled by the inclusion of invoices for one Company in the determination of expense leads for the other and the use of invoices for items other than natural gas. Mr. Subbakrishna explained that it was reasonable to do so because many of the vendors are the same for the two Companies, and because the vendors for the non-gas items are also gas vendors, and provide the other items on roughly the same terms. He also explained that, regardless, there would be no material effect if all of the (in Staff's view) offending invoices were weeded out.

This is readily demonstrated by an analysis of the specific expense leads he calculated. Mr. Subbakrishna developed fuel expense leads of 26.70 days for AmerenCIPS and 28.48 days for AmerenUE. This means that, on average, AmerenCIPS paid for delivered gas 26.70 days after delivery, and AmerenUE paid 28.48 days after delivery. Mr. Subbakrishna testified that the industry is moving toward standard payment terms. Tr. 402 (Subbakrishna). He also assumed that invoices were received 15.21 days after delivery of the gas. Thus, in AmerenCIPS case, the average payment terms were 10.5 days after invoicing, and in AmerenUE's case, payment was made about 13 days after invoicing. Both are consistent with payment terms of "net 10 days."

To have any impact in this case, Staff's argument must be that the use of data for one Company or the use of data for non-gas services skewed the expense lead *downward*, *i.e.*, made the expense lead shorter.[2] There is simply no evidence of this. The AmerenCIPS and AmerenUE expense leads are substantially similar, as Mr. Subbakrishna indicated they would be. There appears to be little difference between the payment terms that both are subject to. Both appear to face payment terms substantially equivalent to the "net 10 days" term that Mr. Subbakrishna testified is becoming the norm.

Moreover, of the hundreds of invoices physically provided to the Staff, and the thousands more made available for inspection, the Staff has not identified even one -- not one -- that suggests that either Company benefits from payment terms that differ materially either from the leads calculated by Mr. Subbakrishna or the terms applicable to the other Company. The Staff cross-examined Mr. Subbakrishna at length about specific invoices, but nowhere in that examination or in any of the extensive evidence submitted by the Staff is there even one example of payment terms that differ in any material respect from the payment terms implicit in Mr. Subbakrishna's analysis. Thus, there is no basis for the Commission to even suspect that one Company receives payment terms of net 30 days, or net 45 days -- or even net 20 days.

The Staff has not even alleged that the payment terms are different from those reflected by Mr. Subbakrishna. The Staff's position is that Ms. Ebrey disapproved of Mr. Subbakrishna's approach. Ms. Ebrey, however, never demonstrated any real-world flaw with the approach. Ms.

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[2] As explained in the Ameren Companies' Initial Brief (p. 13), the longer the expense lead, the lower the cash working capital requirement. Expense leads represent a period of time in which investor funds are not required because the utility has not yet paid for the good or service it has consumed.

Ebrey's concern could be justified if, and only if, the real payment terms experienced by either Company differed materially from the terms implicit in the expense leads developed by Mr. Subbakrishna. But apparently there is not even a single invoice that suggests that this is case. Accordingly, there is no basis for the Commission to conclude that Mr. Subbakrishna's development of expense leads for either Company understated the grace period between invoicing and payment.

The Staff also criticized Mr. Subbakrishna's use of midpoints and obligation dates for fuel and other O&M expenses. Mr. Subbakrishna assumed that: 1) goods and services were invoiced at the end of the month in which they were provided; and 2) on average, goods and services were provided in the middle of the month. This latter assumption simply is that there was, in a statistical sense, a normal distribution of deliveries in a month. That is, goods and services were no more likely to be received on the first day of the month than on the last day of the month. Accordingly, he added to both fuels expense and other O&M expense an "invoice processing time" of 15.21 days -- the average half month that would pass between receipt of a good or service and receipt of the invoice.

Mr. Subbakrishna explained that this made his analysis very conservative, particularly with respect to other operations and maintenance ("O&M") expense. Many O&M items are obtained on a cash basis, so there is no lead time between receipt and invoicing. Tr. 401, (Subbakrishna). Accordingly, the inclusion of an additional 15.21 days for invoice processing time understates the cash working capital requirement.[3]

[3] As explained in their Initial Brief, the Ameren Companies are willing to restore this 15.21 expense lead to other O&M. Mr. Subbakrishna removed it in his surrebuttal testimony in response to criticism from Ms. Ebrey that it was "arbitrary."

Again, the assumption made by Mr. Subbakrishna is reasonable. There is nothing to suggest that the Companies' receipt dates of fuel and other O&M items are bunched toward either end of the month. Mr. Subbakrishna's assumption could only overstate cash working capital requirements if, for example, all gas deliveries were made in the first week of the month, or all pencil purchases were made on the third day of the month. There is no basis to believe that the assumption is wrong, however. There are two types of gas deliveries -- purchases under long-term agreements, and spot purchases. Spot purchases are made when needed or when economic. There is nothing in the record to suggest that such purchases are only necessary or economic at the beginning of a month. Likewise, there is nothing to suggest that deliveries under longer-term supply agreements are concentrated at the beginning of months.

Signally, Staff once again sniffs about Mr. Subbakrishna's assumptions, but fails to put forth a single document even suggesting that the assumptions are unfounded. For all its review of invoices, Staff cannot produce any that indicate that deliveries were skewed toward the beginning of the month -- every month. While the Companies indeed have the burden of proof in this proceeding, it is incumbent on the Staff to produce at least some small indicia that the Companies' analyses are wrong, beyond Ms. Ebrey's personal disagreement with Mr. Subbakrishna's methodology.[4] Based on no evidence whatever that the Companies' calculations may be inaccurate, the Staff nonetheless manages to arrive at the conclusion that the Companies' cash working capital requirements "could" be negative. To achieve "neutrality," the Staff

[4] In this regard, the Ameren Companies note that Mr. Subbakrishna authored several lead-lag studies. Tr. 390 (Subbakrishna); in contrast there is no evidence that Ms. Ebrey has performed even one. Further, Ms. Ebrey has only been involved in the review of one other utility cash working capital study, and then only tangentially, and made no effort to review either other examples of studies or the Commission's review of such studies. Tr. 469-70 (Ebrey).

seemingly sighs, throws up its collective hands, and contends that all it can do is value cash working capital at zero for both Companies.

The Staff's position is nothing short of absurd. Simple arithmetic shows what would have to be true in order for Staff's position to be correct. Using AmerenCIPS' proposed positive cash working capital requirement of $8,005,000 as an example, for the Company's cash working capital requirement to negative, the following would have to be the case:

1) Ignore the separate PGA lag, reducing cash working capital by $3.1 million, AmerenCIPS/UE Ex. 31.0, p.5;

2) All fuel deliveries would have to be made on the first day of every month; thus, instead of an invoice processing time of 15.21 days, there would be an invoicing processing time of 29.21 days; this would reduce cash working capital by $3.396 million;[5] and

3) All other O&M goods and services would have to be received on the first day of the month, none paid for in cash. This would reduce cash working capital by $1.188 million.[6]

The total impact of these three changes in assumptions is $7.684 million, still leaving AmerenCIPS with a positive cash working capital allowance of several hundred thousand

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[5] Mr. Subbakrishna explained in his direct testimony that the expense lead is subtracted from the revenue lag to determine a net lag/lead, which is divided by 365 and multiplied by the test year expense to determine the cash working capital impact. AmerenCIPS Ex. 6.0, pp. 4-5. Here, the addition of 14 days to the expense lead produces a net lag of 13.58 days (versus the 27.58 days in AmerenCIPS' surrebuttal position), which results in a CWC factor of .037, multiplied by fuel expense of $87.984 million, producing a cash working capital impact of $3.273 million, or $3.396 million less than the $6.648 million in the Company's surrebuttal case. AmerenCIPS Ex. 31.1.

[6] The arithmetic is the same as with fuels expense. The restoration of the 15.21 invoice processing time plus an additional 14 days expense lead produces a net lead of 16.35 days (12.86 - 14 - 15.21), which divided by 365 results in a CWC factor of .044, which multiplied by other O&M expense of 13.506 million, results in a cash working capital impact of ($594,000) or $1.188 million less than the $476,000 in the Company's surrebuttal case. AmerenCIPS Ex. 31.1.

dollars. In other words, it is exceedingly difficult to drive AmerenCIPS' cash working capital requirement into red numbers.

Moreover, the assumptions required to get even close are not supported by a single document submitted in evidence in this proceeding. As previously discussed, there is no basis to assume (as would be necessary for Ms. Ebrey's position to even come close to validity) that all goods and services -- every gas delivery, every pencil delivery, every bush trimming at the general office -- occurs on the first day of the month. In other words, AmerenCIPS' gas system would accept deliveries on January 1, then shut itself to further deliveries of system gas for the rest of the month. The Ameren loading docks would receive a mountain of goods on the first day of the month -- then, presumably, send everyone working there home for the rest of the month. Every contractor, every electrician, every repairman, every lawyer, every accountant -- everyone providing services but not employed by Ameren -- would invade (and overwhelm) Ameren installations on the first of the month, then disappear -- not to be seen again until the first of the next month.

The Ameren Companies submit that no business operates that way, and it is ridiculous to assume that it is even possible to operate that way. The far sounder and more rational assumption is the one that Mr. Subbakrishna made -- namely, that it is no more likely that goods and services are received toward the end of the month than toward the beginning. Indeed, Mr. Subbakrishna's analysis indicated that the "majority of the supplies tend to be the same on a daily basis." Tr. 400 (Subbakrishna). Given ample opportunity, the Staff could present no invoice or invoices or other data or evidence that suggest otherwise.

It would be a grotesque injustice to disallow the Companies' proposed cash working capital requirements in full based on the Staff's vague criticisms of entirely reasonable assumptions made by the Companies' experienced consultant. There is simply no basis for the Commission to conclude, as the Staff apparently has, that the Companies' deliveries and receipt of services occur on the first day of the month.

3. Materials and Supplies

4. Working Gas in Storage

The Staff continues to propose an adjustment to the AmerenCIPS test year level of working gas in storage, based on the flawed assumption that multi-year averages of storage inventory provide a better indication of the future than the inventory levels experienced during the test year. However, as the Company explained in its testimony and initial brief, in recent years it has, by intent and design, steadily and consistently increased its use of storage as a hedging tool. Particularly since the winter of 2000-2001, when gas prices shot up to $10 per MMBtu, the Company has embarked on a deliberate path of increasing the level of storage contracted from third parties, enhancing its on-system storage fields through various storage development projects, and maximizing the use of storage available from all sources. In light of these significant changes, it is patently unfair for the Staff to use multi-year averages to reduce the level of working gas included in rate base from the amount experienced during the test year.

From a policy perspective, this proposed adjustment is particularly troubling. Illinois utilities and their customers are facing increasingly volatile gas markets every year. The Commission should be encouraging utility companies to take steps to mitigate gas price swings. On-system and off-system storage fields are the cornerstone of the Ameren Companies' hedging programs. The Companies should not be punished, through disallowances of the type proposed by the Staff, for their increasing reliance on this important hedging tool. Consequently, the Staff's proposed disallowance of working gas costs should be rejected.

5. Accumulated Deferred Income Taxes

As explained in our Initial Brief, the AG proposes a selective adjustment to remove the balance of accumulated deferred income taxes ("ADIT") certain items whose removal would increase the deduction from rate base, and thereby reduce rate base. The AG's adjustment was highly selective. The AG selected only two items -- pensions and OPEBs expense and gas site remediation expense -- which both increase the ADIT deduction.[7]

It is not appropriate to make one-way adjustments. Even if the Commission determines that it is appropriate to examine individual components of ADIT (and for all the reasons discussed in our Initial Brief, it is not), there is no rational or supportable basis for only removing items that decrease rate base. The AG does not even pretend that it made any sort of fair-handed review of the ADIT components. It has simply presented two that reduce rate base. This slanted approach must be rejected.

6. Retirement of Belle Gent

The Staff continues to recommend that the Commission order AmerenCIPS to retire the Belle Gent Storage Field in spite of evidence provided by the Company that the field provides value as a source of late season deliveries, a potential contributor to peak day deliveries, and a backup in the event of failure of the neighboring Johnston City Storage Field. An important factor in the Staff's recommendation is apparently its calculation of the annual cost of operating the Belle Gent Field, which it has determined to be $67,000 per year. Staff's Init. Br. p. 27. In AmerenCIPS' view, a cost of $67,000 per year is not particularly material given that the Company has total annual operating expenses in excess of $135 million even using Staff's

[7] The AG masks this one-sided approach by listing pensions and OPEBs as separate items, but they go hand-in-hand. Overall, the removal of pensions and OPEBs ADIT reduces rate base. Specifically, for AmerenCIPS, Mr. Effron removes a credit of $840,000 for pensions, and a debit of $2.441 million for OPEBs – overall producing a rate base decrease of $1.601 million. AG Ex. 1.0 CIPS, Sch. B-2.

calculations. Staff Init. Br., Appendix A, Schedule 1, line 24. Moreover, the incremental costs that the Company incurs in order to operate the field each year (beyond the sunk costs incurred in developing the field and supplying working gas) are far less. Company witness Davis testified that the operating and maintenance costs attributable to the field during the test year were less than $3,600. This is a *de minimus* cost under any standard, and is clearly outweighed by the benefits the storage field provides.

It is noteworthy that Mr. Lounsberry, the Staff witness who is recommending that the Commission order the retirement of the Belle Gent field, admits that he has never, throughout the course of his career, had any responsibility for the operation of any natural gas storage field. In addition, he has never even visited the location of the Belle Gent field. Tr. 532 (Lounsberry). Under these circumstances, Mr. Lounsberry's recommendation that the Commission take the unusual step of ordering the retirement of the Belle Gent field should be rejected.

D. Recommended Rate Base

III. Operating Revenues and Expenses

A. Introduction

B. Uncontested Issues

C. Contested Issues

1. Uncollectible Expenses

The Staff continues to support its five-year average method for determining the level of uncollectibles expense. The entirety of Staff's arguments is defending Ameren's challenge to this method. Staff Init. Br., pp. 33-36. Notably, Staff never explains either why (1) it believes the test year amount is wrong, or (2) why the use of a five-year average is appropriate. In this instance, the Commission's Staff bears the burden of demonstrating why the test year amount is overstated. *City of Chicago v. Commerce Comm'n*, 133 Ill. App. 3d 435, 442, 478 N.E.2d 1369, 1374 (1985).

The Staff's brief comments at length on Ameren's reliance on gas prices to demonstrate the impropriety of the five-year method. The hard and cold facts concerning gas prices are these: the average price of natural gas for 1998 was $2.108 per MMBtu; for 1999: $2.268 per MMBtu; for 2000: $3.886 per MMBtu; for 2001: $4.273 per MMBtu; and, in 2002: $ 3.221. In 1998 and 1999, it was not uncommon for the price of gas in a month to be in the $1.80 per MMBtu range whereas in 2001 and 2002, gas prices had doubled and $4 prices were not uncommon. AmerenCIPS/UE Ex. 11.4. Clearly and unequivocally, gas prices were significantly increasing during the five-year period, a fact completely lost in Staff's method.

The Staff disputes that there is any correlation between gas prices and uncollectibles expense. Staff argues that Ameren witness Opich agreed there was no such relationship. Staff Init. Br., p. 34. The Ameren witnesses testifying regarding the relationship between uncollectibles expense and gas prices, however, were Ms. Laurie Karman and Mr. Jim Davis; Mr. Opich testified to the accuracy of the test year amount and accounting treatment. Notably, Staff did not cross-examine either Ms. Karman or Mr. Davis on this issue.

Moreover, the reference to Mr. Opich's cross-examination is not a correct reading of the record. Mr. Opich's testimony cited by Staff was merely his reading into the record information from Staff witness Ebrey's schedules -- hardly impeaching testimony. Mr. Opich never conceded anything about the relationship between gas prices and uncollectibles. Indeed, when asked the "$64,000" question, Mr. Opich explained why Ms. Ebrey's schedules are irrelevant, as explained below.

Mr. Opich testified there are certain adjustments reflected in Account 904, which is the essence of Ms. Ebrey's schedules. At the end of each year, there may be positive or negative balances which are driven in part by the adjustments or carry over from prior years. Tr. 298; Staff Ex. 3.0, Schs. 3.3 UE and CIPS. The accruals to Account 904 are based on budgeted (forecasted) information. For example, the Account 904 column for the year 2000 shows a negative number, $112,000, because the actual amount was less than the budgeted amount. Obviously there were actual uncollectibles expense in that year but the adjustments for the prior year resulted in a negative balance. In short, the Staff schedules are accounting entries only and do not demonstrate actual uncollectibles expense in given year, nor do they serve any purpose in identifying whether a correlation exists between gas prices and this expense.

Staff contends that use of gas forecasts somehow is an affront to the historical test year. The argument also made is that somehow the use of storage and hedging bears upon the level of uncollectibles expense. Staff Init. Br., pp. 34-35. Both of these arguments have been refuted in the Companies' Initial Brief (pp. 37-38) and in testimony. Ameren CIPS/UE Ex. 24.0 pp. 20-21. Further, we note that storage and hedging were both available and used during the test year and, therefore, any impact they had on uncollectibles expense is reflected in the test year amount.

Staff also contends that there is some correlation between temperatures and uncollectibles expense. Staff Init. Br., p.35. Ameren does not disagree. If temperatures drop, and more gas is used, all things being equal, the customer's bill is higher and there is a greater likelihood of uncollectibles expense. Our point remains that the amount of the bill has a direct bearing on uncollectibles expense. So, if temperatures drop, and more gas is used, all other things being equal, the customer's bill is higher and there is a greater likelihood of uncollectibles expense.

Significantly, there was no aberrant weather in the test year that would suggest that uncollectibles were abnormally high. To the contrary, Ameren witness Daniel Danahy reviewed the weather, and proposed very modest weather normalization adjustments, which no party disputed. Further, the Staff made no effort to back out the effects of weather from its own five-year average, which could be skewed by weather.

The AG's brief is mostly a regurgitation of its witnesses' testimony supporting the five-year average method. AG Init. Br., pp. 12-13. Its arguments fail for the same reasons as Staff's.

The AG claims the expense is "abnormally high in the test year." AG Init. Br., p.12. The evidence offered in support of this claim is -- well, none. There is no testimony or evidence from the AG, or Staff for that matter, which purports to explain why the test year amount is "abnormally high." The AG summarily concludes a five-year average "provides an adequate sample size." AG Init. Br., p.13.

Finally, the AG contends its method does account for the increase in gas costs. AG Init. Br, p.13. Frankly, the AG argument is hard to follow but it seems to be that because PGA revenues increase because the price of gas has increased, the uncollectibles expense will also increase. In response, the evidence does demonstrate a correlation between gas prices and uncollectibles expense. The AG position fails, though, because of the five-year averaging of this expense which largely ignores the more current price of gas and its impact on customers and their ability to pay.

2. VRP Cost Recovery

In its Initial Brief, the Staff continues to oppose recovery of any of the costs associated with the VRP, while reflecting all of the savings. The Staff stubbornly clings to its view that the annual pension and OPEB expenses are already reflected in the test year, and that any reflection of the VRP costs in the test year would constitute double recovery. Specifically, the Staff argues

(p. 37) that "continuing recovery of pension and OPEB expense for employees who have actually retired supplants the need for the Companies to also recover the VRP costs. . . ."

Ameren witness Vogl could not have been clearer on this point. There is an incremental cost that is not reflected in the pension and OPEB expense and that, if not reflected in rates now, will never be reflected or recovered through rates: "a one-time cost is recognized which equals the value of the difference between the benefits earned to date and the benefits to be received by the voluntary retirees. This one time cost recognizes the accrual of the VRP benefits, and is the pension and OPEB costs incurred to implement the VRP." AmerenCIPS/UE Ex. 30.0, p. 4. Moreover, the 2002 actuarial study, which recognized the retirees as employees provides no cushion with which to absorb the one-time cost: the movement of VRP participants from "employees" to "retirees" does not produce a reduction in pension costs. Tr. 103 (Vogl).

Staff agues that Mr. Vogl's updated analysis (discussed in Section III.C. 5, *infra*) is unreliable because it reflects the acquisition of Central Illinois Light Company ("CILCO"). To the contrary, Mr. Vogl explained repeatedly that he backed out the effects of the CILCO acquisition. Tr. 100-01, 104, 109-11 (Vogl).

3. Amortization of VRP Costs

The AG argues (Init. Br., pp. 14-16) that the Companies' VRP costs should be amortized over a period of 10 years, rather than the three years proposed by the Companies.[8] The AG contends that, with a three-year amortization period, the annual costs exceed the annual savings. The AG calculates that AmerenCIPS' customers are about $63,000/year worse off with the VRP

[8] As noted, the Staff contends that there should be no recovery of these costs at all. The Staff also argues, however, that should recovery be allowed, the costs should be amortized over the 10 year period proposed by the AG. (Staff Init. Br., p. 38.)

than without, while AmerenUE's customers are some $15,000/year better off. The AG then concludes that a 10-year amortization period better matches costs and savings.

The Ameren Companies do not believe that it is appropriate to extend the amortization of the VRP costs beyond the expected life of the rates set in this proceeding. The Ameren Companies have estimated three years; the Staff and the AG have estimated five years. Accordingly, in the event that the Commission concludes that a three-year amortization of the VRP costs is too rapid, in no event should the amortization exceed five years.

The AG made much of the fact in this case that the recognition of the VRP costs on the Companies' books is an accrual and not an out-of-pocket payment. Pension and OPEB costs are booked on an accrual basis, but that does not mean that the Companies never have to make cash outlays for those costs. The AG's proposal, however, essentially assumes that the VRP has no cash consequences.

The AG argues in its Initial Brief (p. 15), that a 10-year period will "align the costs of the program with the time period over which VRP expenditures will be made." The AG assumes that, on balance, employees taking the VRP retired 10 years early. As explained in the Ameren Companies' Initial Brief (pp. 42-43), however, a ten year amortization period would extend the recovery of costs beyond the savings period associated with many employees who accepted the early retirement offer. Ameren witness Opich explained that, of those employees accepting the VRP, most were near normal retirement age. The VRP put employees into the OPEB plans only a few (and certainly not ten) years earlier than they normally would have been. Most of these employees would have been drawing from the pension plan and having their medical expenses paid through the OPEBs long before the ten-year period expires. AmerenCIPS/UE Ex. 14.0,

p. 13. The AG's contention (p. 15) that VRP "expenditures are likely to continue long after" three years is based on supposition, not fact, and the AG's proposal should be rejected.

4. Backfill of VRP Positions

The Ameren Companies explained in this proceeding that Ameren intended to hire 76 new employees to "backfill" positions vacated by some of the employees opting for the VRP. The Ameren Companies proposed pro forma adjustments to the test year to reflect the costs associated with the backfill positions.

The Staff initially opposed reflection of any of the backfill costs in the test year. The Companies thereafter submitted additional evidence regarding the progress toward filling the backfill positions, and, at the hearing, Staff witness Jones agreed that the Companies had demonstrated that 60 of the positions had been filled. Tr. 431 (Jones). Accordingly, in its Initial Brief, the Staff reflected the 60 positions in its final recommended revenue requirement. (Staff Init. Br., p. 40; App. A, Sch. 6; App. B, Sch. 6.)

The Staff continues to oppose the reflection of the remaining 16 positions in rates. The Staff explains that the labor expense associated with these 16 positions is not known and measurable because Ameren witness Lindgren did not identify the date on which the 16 would be hired or the date on which the Companies will begin to incur labor expense associated with the 16 positions. (Staff Init. Br., pp. 39-40.)

As noted in the Ameren Companies' Initial Brief (pp. 43-44), the Staff's application of the known and measurable requirement is too restrictive. Mr. Opich and Mr. Lindgren testified that all management approvals have been obtained and that all positions will be filled by the end of the summer, which is well before the 12-month cut-off date for pro forma adjustments. AmerenCIPS/UE Exs. 14.0, p. 7; 28.0, p. 5. Accordingly, these positions should be reflected in rates.

5. Pension and Benefits Expense

As explained in the Ameren Companies' Initial Brief, in this case, the Ameren Companies proposed pro forma adjustments to their test year pension and benefits expense to reflect anticipated changes in the level of those expenses. The Companies thereafter submitted an update to their adjustments to reflect the results of the VRP and certain other developments, including a cap on medical benefits. The updated adjustment was lower than the adjustment proposed in the initial filing.

In its Initial Brief (p. 16), the AG recommends "disregarding the pension and OPEB expense figures offered by [Ameren]CIPS and [Ameren]UE in this case because [they] have offered nothing to justify or support the reasonableness of those figures." According to the AG, the Ameren Companies' proposed amounts are "nothing more than unsupported conclusions." The AG also argues that the there is no presumption in favor of the Companies' amounts; they are not supported by an actuarial study; and they are based on improper surrebuttal. None of these arguments has any merit and all should be disregarded.

<u>The Companies' figures are presumed to be reasonable</u>

In rate proceedings before the Illinois Commerce Commission, a public utility may justify its proposed rate by showing that certain costs are necessary to provide service. This initial showing constitutes the utility's *prima facie* case, which may be rebutted by evidence that the utility is inefficient or has acted in bad faith by including in the proposed rate some or all of the disputed costs. Historically, the costs presented as part of the *prima facie* case of the utility were invariably presumed reasonable absent an affirmative showing that they are not reasonable. *See City of Chicago v. Illinois Commerce Comm'n,* 133 Ill. App. 3d 435, 442, 478 N.E.2d 1369, 1374 (1985). However, subsequent statutory amendments eliminated the presumption of reasonableness with respect to costs incurred to construct new power plants. Under the new regime, utilities must present evidence, including information generated by an independent auditor, that the construction costs are reasonable. *See* 220 Ill. Comp. Stat. 5/9-213 (2003).[9] In the face of this showing by the utility, other parties may introduce rebuttal evidence challenging the reasonableness of the costs. *See People ex rel. Hartigan v. Illinois Commerce Comm'n,* 117 Ill.2d 120, 133-34, 510 N.E.2d 865, 870 (1987).

Hartigan concerned a rate increase which included costs related to the construction of a nuclear power plant near Byron, Illinois. The utility presented audit data to the Commission, but the data did not comply with Section 9-213, so the Supreme Court of Illinois was forced to consider the effect of Section 9-213 on the presumption of reasonableness previously accorded to costs submitted by utilities. The utility argued that "the enactment of [Section 9-213] did not eliminate [the] presumption" but the Supreme Court ultimately disagreed. *Hartigan,* 117 Ill.2d at 132, 510 N.E.2d at 870.

While *Hartigan* eliminated the presumption that construction costs are reasonable, it left in place the presumption that other costs are reasonable. First, as noted above, the facts of *Hartigan* revolve around construction costs, not other costs. Second, the supreme court frequently reiterated that it was construing the treatment of costs related to construction. *See, e.g., Id.* at 133, 510 N.E.2d at 870 ("Under [Section 9-213,] the audit now provides the primary means by which the Commission is to determine the reasonableness of the costs associated with the construction of power plants."); *Id.* at 135, 510 N.E.2d at 871 ("The purpose of the audit . . . is to assist the Commission in determining whether the costs of constructing a plant were reasonable and should therefore be allowed into the utility's rate base."); *Id.* at 136, 510 N.E.2d at 872 (Performing audits "of the costs of new utility plants is central to ascertaining

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[9] This provision has been affected by several statutory compilations, thus, several citations appear in the decisions. For simplicity, we refer to this provision as Section 9-213.

reasonableness under [Section 9-213].”). Third, the court examined the legislative history of Section 9-213 and concluded that the presumption regarding construction costs was altered because presuming the validity of potentially enormous expenditures undermined the confidence of the public that utility rates are reasonable. This legislative history did not refer to other outlays by utilities and did not examine other provisions of the Illinois Public Utilities Act. *See Id.* at 133, 520 N.E.2d at 870. Finally, the *Hartigan* court examined the auditing standards required by Section 9-213, a consideration irrelevant to other provisions. *See Id.* at 136-37, 510 N.E.2d at 872. The review of auditing standards underscores the fact that the court was construing a specialized statute, not the general treatment of cost data by the Commission.

After the Supreme Court ruled in *Hartigan,* the case continued to move through the Illinois courts. In a subsequent decision, *People ex rel. Hartigan v. Illinois Commerce Comm'n,* 202 Ill. App. 3d 917, 561 N.E.2d 711 (1990) (*“Hartigan II”*), the court examined *Hartigan* in order to apply the Supreme Court’s mandate. According to *Hartigan II,* “the Commission must ensure that no costs associated with the construction of a new electric utility generating plant are included in the rate base unless the costs are reasonable.” 202 Ill. App. 3d at 935, 561 N.E.2d at 722. The court in *Hartigan II* further emphasized that audits were “the primary basis” for determining reasonableness under Section 9-213, and that “only when the audit report or other affirmative evidence satisfie[d] the Commission that the construction-related costs [were] reasonable [could] those costs be included in the rate base.” *Id.* at 937, 561 N.E.2d at 722. *Hartigan II* did not state or imply that the rule annunciated in *Hartigan* applies to all costs submitted by utilities.

The Public Utilities Act applies to utilities other than power companies, such as telephone companies. The reasoning of the court in *Illinois Bell Telephone v. Commerce Comm'n,* 327 Ill.

App. 3d 768; 762 N.E.2d 1117 (2002), indicates that the presumption of reasonableness still applies to costs unrelated to power plant construction. Ameritech challenged various aspects of a Commission ruling, including the exclusion of certain charges from its rate base. *See Id.* at 776, 762 N.E.2d at 1123. Ameritech claimed that excluding the costs ignored the presumption that they were valid. The court upheld the exclusion because the Commission was persuaded by rebuttal evidence that the costs were unreasonable. However, concerning the presumption of validity, the court stated:

> In proceedings before the Commission, once a utility makes a showing of the costs necessary to provide service under its proposed charges, it has established a *prima facie* case. The burden then shifts to others to show that the costs incurred by the utility are unreasonable because of inefficiency or bad faith. . . . Here, we agree with Ameritech that once it submitted its costs studies it made a *prima facie* case supporting its collocation costs. It was then incumbent upon the staff to show that the costs incurred by Ameritech were unreasonable.

Id. at 777, 762 N.E.2d at 1124 (citations omitted). In the end, Ameritech lost because persuasive evidence challenged its costs studies, not because there was no presumption concerning the reasonableness of the costs.

Finally, the Commission itself has endorsed the continued vitality of the *City of Chicago* presumption that costs not related to generating plant construction are valid. In several decisions the Commission accepts the arguments of the utility that cost submissions are presumed valid unless they are related to construction. In *The Peoples Gas Light and Coke Company: Proposed general increase for rates for gas service,* the Commission stated:

> [The utility] cites [*City of Chicago*] as stating the correct burden of proof standard regarding issues relating to its environmental costs. . . . [The utility] also submits that in *Hartigan,* the Illinois Supreme Court held that [Section 9-213] set a higher burden of proof standard than that announced in *City of Chicago,* but only as to the costs of constructing electric generating stations. [The utility] contends that, as to other costs, the *Hartigan* Court did not disturb

> the "historic presumption of reasonableness" announced in *City of Chicago.*
>
> The Commission agrees with [the utility] that *City of Chicago* states the controlling burden of proof standard. Under the holding of that case, [the utility] had to make a showing of the costs necessary to provide service under its proposed rates in order to establish a *prima facie* case. At that point, the burden shifted to others to show that [the utility's] costs were unreasonable.

1992 Ill. PUC LEXIS 376, *153 (Ill. Commerce Comm'n 1992); *see also Illinois Commerce Commission On Its Own Motion: Investigation concerning issues related to coal tar clean-up expenditures with respect to Central Illinois Light Company,* 1992 Ill. PUC LEXIS 379, *27 (Ill. Commerce Comm'n 1992) (agreeing with the utility that "*Hartigan* did not alter [the] historic presumption of reasonableness, nor require a utility to make an affirmative showing of reasonableness at the outset of its case, except with respect to construction costs of electric generating plants, as specified in Section 9-213," and applying presumption in decision) (internal quotation marks omitted); *North Shore Gas Company: Proposed increase in natural gas rates,* 1991 Ill. PUC LEXIS 636 (Ill. Commerce Comm'n 1991) (same).

<u>The AG has failed to meet its burden of going forward</u>

Once a utility has made a *prima facie* case that its costs are reasonable, this showing by the utility shifts the burden of production to the party challenging the costs. The party must present some evidence in rebuttal or the utility prevails. This burden of production is sometimes dubbed the "burden of going forward." *See City of Chicago,* 133 Ill. App. 3d at 442-43, 478 N.E.2d at 1375. The burden of going forward entails production only, not persuasion -- the party with the burden must produce some evidence. *See Verizon North Inc. and Verizon South Inc., Verified Petition for Certification,* 2003 Ill. PUC LEXIS 547, *160-*62 (Ill. Commerce Comm'n 2003) (Intervening parties "have a burden of going forward. . . . [O]nce a utility establishes a *prima facie* case, the burden then shifts to others to show that the company's case is unreasonable. [*City of Chicago.* Nevertheless, the intervenors] attempt to make their cases through general objections, not evidence. They repeatedly state conclusively that they need data . . . but they never provide support explaining why such data is necessary or relevant. They simply summarily state that such data is necessary."); *Commonwealth Edison Company, Petition for approval of delivery services tariffs,* 2003 Ill. PUC LEXIS 311, *124 (Ill. Commerce Comm'n 2003) (party with burden "must do more than offer conjecture and unsupported claims").

Here, the AG has presented nothing but objections. It has not produced one scintilla that would indicate that the Companies' proposed expense levels are unreasonable. Accordingly, the AG's attack must fail.

<u>The Companies' figures are not unsupported</u>

The AG incorrectly asserts that the Companies' revised figures were unsupported. The figures were prepared by the Companies' actuaries, Towers and Perrin, the very same actuaries who determine the historical expense to be booked for GAAP purposes, including the 2002 historical expense that the AG would prefer to use. It is not essential that expert testimony be accompanied by reams of workpapers. The point is that the professional actuary, Mr. Vogl, prepared both the initial and updated estimates, and that the AG's resource, Mr. Effron, is not an actuary and is no position to offer his own actuarial assessment (nor did he). The only person in this case competent to assess the initial estimate prepared by Mr. Vogl was Mr. Vogl, and when he did so, he revised it to reflect changes that had occurred since the time of his estimate -- the VRP and the change in medical benefits, as well as changes in the market.

As we have noted, the Companies introduced the full update to *decrease* their request. Mr. Vogl could have submitted testimony in response to Ms. Jones telling part of the story -- that revision of his estimate to reflect simply the movement of some employees from employment to retirement would not alter the level of pension costs -- without telling the whole story. And the whole story is that there have been various changes, including the retirement of the VRP participants, which overall have reduced the level of pension and OPEB costs. The Companies believed (and still believe) that good faith directed them to disclose these changes to the Commission and they did so. Since no good deed goes unpunished, the AG (which has no independent basis for its own adjustment) now seeks to use this against the Companies.

Lastly, these are not numbers generated by the Companies themselves on a whim. The Companies rely on their actuary to provide the numbers they book as expenses in accordance with GAAP. What the AG is saying that Mr. Vogl's calculations pursuant to GAAP for 2002 can be trusted, but his calculations for 2003 cannot. He is no less competent this year than last, however, and the Ameren Companies will again rely on Mr. Vogl to develop expense levels for GAAP purposes. The AG's position is groundless.

Mr. Vogl's testimony was not improper surrebuttal

The AG repeats its claim that Mr. Vogl's testimony was improper surrebuttal that prejudiced the AG. In a new twist, the AG also accuses the Companies of "misleading" a Staff witness through a question (to which the AG did not object) at hearing.[10]

The AG's brief on this point is a torturous exercise, a verbal safari in search of an elusive "double-counting." The matter is quite simple. Ms. Jones argued that the Companies had double counted in the test year, because test year pension expense counted the VRP participants as active employees, not retirees. As explained in the Ameren Companies' Initial Brief (pp. 41-42), Mr. Vogl acknowledged that the participants were indeed assumed to be employees, but that there was no overall overstatement of pension expense, because moving the participants to the

[10] The AG, like any party, is free to object to questions directed to another party's witness in order to protect the record.

proper classification did not produce the reduction in pension expense that Ms. Jones assumed it did.

At that time, Mr. Vogl presented a recalculation of pension and OPEB expense to reclassify the employees. So as not to present a one-sided picture of these costs, he adjusted for all changes occurring since the initial filing, which, as we have noted repeatedly, reduced the requested level of these costs.

There has been nothing underhanded or unseemly about the Companies' actions. To the contrary, it is the AG whose position is less than above-board. The AG is determined to establish that the proper level of expense going forward is the 2002 booked expense – though it lacks any study or any competent testimony to explain why.

The AG's effort should be recognized for what it is – a transparent effort to manufacture a downward adjustment in revenues, based on no analysis whatsoever. Instead, the AG attacks the integrity of the Companies and their counsel, and attempts to bludgeon the record into a shape that suits its purpose. These crude tactics do not get the job done, and the AG's groundless adjustment must be rejected.

6. Pension and Benefits, Capitalization Ratios

The AG asserts that Ameren could not explain why capitalization rates for pensions used by the Companies differed from the labor rates used by AG witness Effron. To the contrary, Mr. Opich explained that the rates used by the Companies conform with GAAP and reflect factors not included in the data Mr. Effron used. AmerenCIPS/UE Ex. 14.0, p. 19.

The AG also accuses the Companies of inventing a "test quarter," which the AG asserts violates the test year rule. The AG asserts (without benefit of record citation) that "expenses calculated quarterly represent too narrow a slice of conditions" to be used when determining rates. The Companies believe that their methodology was reasonable and there is no <u>evidence</u> to suggest that it was not.

Lastly, Ameren witness Opich did not testify, as the AG implies, that the capitalization ratios for pension costs proposed by the AG would be appropriate under GAAP for the relevant time period. There is no evidence to suggest such a proposition. Notably, the AG's witness, an accountant, did not offer such testimony.

7. Wage Expense, 2003 Collective Bargaining Unit Increase

The Companies do not yet have written agreements with their collective bargaining unit personnel; accordingly, the Companies concede this adjustment.

8. Incentive Compensation Plan Expenses

The Commission Staff and AG both continue to recommend the disallowance of the incentive compensation costs incurred by AmerenCIPS and AmerenUE in the test year, despite the uncontested evidence in this proceeding that the incentive compensation program has provided significant, measurable customer benefits in a number of areas. As explained in detail in the Companies' initial brief, the evidence shows that the key performance indicators in the Companies' incentive compensation plan have played an important role in increasing the percentage of bills mailed on time, enhancing cost controls, improving the Company's safety record, reducing gas supply transportation and storage costs, improving the Company's response to leak calls, and improving compliance with federal and state safety standards. In addition, on a more general level, in 2002 the Company was recognized as an industry leader in customer satisfaction in two independent customer satisfaction surveys, in no small part due to the impact of the customer-focused key performance indicators in the incentive compensation program. Ameren Init. Br., pp. 46-49.

The uncontested evidence also shows that the incentive portion of the Companies' compensation package is necessary to bring their employees' overall compensation to a level commensurate with the industry median. The evidence indicates that without the incentive portion of the compensation package, the Companies would have difficulty attracting and retaining quality employees. AmerenCIPS/UE Ex. 16.0, pp. 7-9.

Notwithstanding this evidence, the Staff and AG support their proposed disallowance with two principal arguments: first, the incentive costs might not be incurred in the future, either because the required targets were not reached or because management could possibly choose to terminate the plan; and second, because the incentive compensation is funded based on earnings, it primarily benefits shareholders, not the Company's customers.

As explained in the Companies' Initial Brief, both arguments lack merit. Although *by definition* incentive compensation costs might not be incurred in any particular future year, that fact does not mean that incentive compensation costs should be disallowed from rates. Indeed if that was the standard, no incentive compensation costs could ever be included in any utility's rates under any circumstances, and many other normal costs incurred in the test year would be disallowed simply because there is no absolute guarantee that they will recur in the future. In this case, the evidence shows that the Companies paid incentive compensation during the test year at only 80% of the targeted level, and therefore it is likely that more incentive compensation, not less will be paid in future years. Tr. 46 (Lindgren). The evidence shows that the test year level of incentive compensation is a normal amount that can be reasonably be expected to be incurred in the future, and nothing more is required to permit inclusion of these costs in rates.

Regarding the argument that the plan is somehow tainted because it is funded based on earnings, the evidence shows that earnings based measures are the most common measures used in annual incentive plans for all companies. AmerenCIPS/UE Ex. 16.0, p. 13. Staff witness Jones herself admitted that customers as well as shareholders can benefit from measures that increase earnings, such as cost savings measures or increases in the number of customers, which allow the Companies to spread fixed costs over a broader base. Tr. 452-53 (Jones). Indeed, a fundamental premise of utility regulation is that the Company's incentive to increase earnings between rate cases will ultimately redound to the benefit of customers, when rates are re-set to reflect these efficiencies. Contrary to the Staff's implication, there is nothing inherently wrong with tying incentive compensation funding to earnings, particularly where, as in this case, it is also necessary for employees to meet customer-focused performance indicators in order to earn the incentives.

The Staff and AG cite a number of Commission cases in support of their disallowance of incentive costs. However, as explained in the Companies' Initial Brief, Illinois cases have both permitted and disallowed incentive compensation costs. Precedent does not require the Commission to disallow the incentive compensation costs in this case. As the Staff has correctly described the situation in its Initial Brief (p. 47), "every case stands on its own merits." In this case, the Companies have shown that a normal and reasonable amount of incentive compensation costs were incurred in the test year; the Companies' customers have derived substantial, measurable benefits from the incentive compensation program; and the incentive portion of the employees compensation package is necessary to attract and retain quality employees. Consequently, the merits of this case support inclusion of the incentive compensation costs in rates.

9. Advertising Expense

10. Meter Reading Expense, Non-Labor

The AG contrives an argument, based on its cross examination exhibit (AG Cross Ex. 4.0), that $81,000 of the $181,000 cost at issue be removed because billing system transition related costs will not be incurred in the test year. AG Init. Br., p.25. While that exhibit generally addresses the switch to automated meter reading, little else is mentioned in terms of the billing system. Indeed, the amounts the AG references do not even appear on the exhibit!

Further, the evidence in the record demonstrates that the automated billing system was largely in place in the late 1990's and completed in 2001. Since 2001, these expenses have been constant because of the contract in place with the vendor, and there is no "transition" taking place in the test year as the AG groundlessly assumes. AmerenCIPS/UE Ex. 23.0, p. 8.

The AG recommendation should be rejected.

11. Income Tax Expense

12. Allocation of Rate Case Expense

13. Amortization of Rate Case Expense

D. Recommended Operating Income/Revenue Requirement

IV. Cost of Capital/Rate of Return

A. Capital Structure

1. Uncontested Issues

2. AmerenUE, Common Equity Percentage

Staff's adjustment to AmerenUE's capital structure assumes that there is a maximum level of common equity above which a utility may not reasonably go. Staff does not define this level as the upper end of a reasonable range, but, rather, as something that is almost average.[11] Staff's Initial Brief (p. 54) notes that the S&P benchmark debt capital range for an AA-rated utility with a business position of 3 is 42.0% to 47.5%. Rather than capping AmerenUE's non-debt capital at 58% (100% - 42%), Staff caps it at 55%. *Id.*

Thus, in Staff's view, utilities with total debt capital of 42.0% - 44.9% have excessive equity – even though they are within the benchmark range that Staff relies on. If there is a normal distribution of utilities within the range Mr. McNally relies on, over half of them would have excessive non-debt capital.

Hence, at the very least, Staff's adjustment is significantly overstated, even if one accepts that AmerenUE has excessive equity capital. AmerenUE submits that it does not, for all the reasons stated in its Initial Brief.

3. Short-Term Debt Balance

4. Recommended Capital Structure

B. Cost of Debt

1. Cost of Long-Term Debt

In its Initial Brief (pp. 61-62), Staff argues that the Companies have not substantiated various "claims and assumptions" they have made. The only "claim" the Companies have made is that an average over 12 months is likely a better indicator of longer term conditions than a single day snapshot, particularly where that snapshot is taken at a time of historic lows.

2. Cost of Short-Term Debt

C. Cost of Preferred Stock

D. Cost of Common Equity

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[11] Mr. McNally actually requires more debt capital than the average of the range he relies on. He uses the S&P AA benchmark range of 42.0%-47.5% debt capital, the arithmetic average of which is 44.75%. Mr. McNally actually requires more debt – 45%.

E. Recommended Overall Rate of Return on Rate Base

V. Cost of Service Study

A. Introduction

B. Uncontested Issues

C. Contested Issues

1. Allocation of Transmission Plant

2. Allocation of Distribution Plant

3. Allocation of Account 383

4. Allocation of Account 386

5. Allocation of Account 879

6. Allocation of Account 902

In their Initial Brief (p. 104), the Ameren Companies incorrectly stated that Staff's use of a meter assumes that meter-reading expenses for AmerenCIPS are directly related to the cost of the meter. As noted by Ameren witness Difani in his surrebuttal testimony, Staff allocated these costs based on the number of meters, not their costs. AmerenCIPS/UE Ex. 33.0, p. 6. This does not salvage Staff's proposal, and the Ameren Companies stand by their allocation of this account.

7. Allocation of Account 912-916

8. Allocation of Storage Costs Between Sales and Transportation Customers

9. Allocation of Revenue Requirement

VI. Rate Design; Tariff Terms and Conditions

A. Introduction

B. Uncontested Issues

C. Contested Issues

1. Residential Customer Charge

2. Residential Usage Charge, Flat vs. Declining Block

The Staff continues to endorse a flat rate block in order to reduce consumption, but refuses to make any adjustment to the billing parameters in order to reflect a reduction in consumption. If the Staff's proposal produces the Staff's desired reduction in consumption, then the billing units must be adjusted to reflect that reduction or AmerenCIPS and AmerenUE will under-collect their revenue requirements under normal weather conditions. That is irrefutable logic, which no court could ignore.

The Staff has presented no analysis or quantification of the effect of its proposal on consumption, which either means that the Staff does not know what the effect will be, in which case it is not appropriate to implement it, or it does not believe it will have any meaningful effect, in which case it is also not appropriate to implement the proposal.

As we explained in our Initial Brief, if the Commission elects a rate structure to curb consumption, then it must adjust the test year billing units to reflect that reduction in consumption. The record, however, is devoid of any basis on which to quantify such an adjustment. Accordingly, the record cannot support the Staff's proposal.

Moreover, the Ameren Companies note that the Staff's proposal accepts as fact matters which the scientific community is still debating: global warming itself and the impact of fossil fuel consumption on climate. The Staff cites no source indicating either that global warming is a fact or that fossil fuels affect consumption. Instead, the Staff has cited very carefully worded and qualified statements of government agencies, which indicate that there "could" be an adverse effect on climate. The Staff has chosen to utterly ignore the plain language ("uncertainties exist about exactly how the earth's climate responds" to so-called greenhouse gases, and act is if there is a defined and undeniable "cost to society" from fossil fuel consumption.

This is not the forum to debate whether global warming is a fact or what “indirect environmental costs” append to the consumption of fossil fuels. Our point here is that it is particularly inappropriate to adopt a consumption-curbing strategy with adjusting for the loss of consumption in order to address a “problem” that has not been established to a scientific certainty and the costs of which are wholly undefined.

Further, the record is completely devoid of any analysis of whether a reduction in gas consumption will mitigate any climatic problem that may exist. A reduction in cold weather may lead to other activities (electric space heating, *e.g.*) that have their own potential climatic impacts. There is no showing that such alternative measures would not pose an equal or greater climatic threat.

3. Size of Residential First Block

4. Grain Dryer Rate

BEAR proposes that a special rate be developed for customers engaged in grain drying. BEAR proposes to separate the existing Rate 3 class into two groups: “grain dryers” and everyone else. BEAR Init. Br., pp. 1-11. BEAR has failed to demonstrate a need for this end user rate, or offer a meaningful definition of the qualifying class.

BEAR offers a great deal of discussion as to the load characteristics of grain dryers. *See* BEAR Init. Br., pp. 2-3, 5 and 8; Ameren Init. Br., p.114 in response. BEAR argues that its members only use gas during distinct times of the year, and, as a result, are imposing lower costs on the system. The evidence though is not as clear as BEAR contends. BEAR witness Smith testified the grain dryer process is not fluid: “I believe that sometimes it is necessary to start up and do additional drying.” Tr. 242. She also admitted there are certain days during the winter where grain dryers would not operate for economical reasons. Tr. 244-45. The sometimes stop and start characteristics of this load and economic considerations at hand, necessitates a distribution system capable of handling these fluctuations, a consideration overlooked by BEAR in its demand for a lower rate for grain dryers.

In addition, BEAR's contention that it only uses gas during certain months does not alone qualify it as a "high load factor" class. High load factor customer classes are those that use the same or similar amounts throughout the year. *See*, *Commonwealth Edison Co.*, Ill.C.C. No. 99-0717, 1999 ILPUC LEXIS 647, *190 (Aug. 25, 1999).

Ameren witness Jon Carls explained that, to design rates, there is a need for billing parameters, meaning knowing the number of customer bills and volume of usage in a test year. In the cost of service study dollars would then be allocated to this "class." Tr. 151. This requires some meaningful estimate of class size. Without this basic information, a cost based rate cannot be developed.

Crudely dividing Rate 3 into two classes does not promote proper rate design. Additionally, the best cost data available to AmerenCIPS suggests that these customers are Rate 3 customers. The cost of service study utilized by AmerenCIPS in setting rates relies upon customer characteristics and other factors. For example, customer and demand-related costs and allocations are determined by considering customer specific attributes. AmerenCIPS. Ex. 9.0, pp. 4-6.

BEAR, in effect, assumes the result: that there is some homogenous group with similar size and usage characteristics. But it has not demonstrated what size and usage should define the class. No billing determinants are offered and the usage characteristics described by BEAR are vague at best. BEAR witness Smith conceded she relied on usage data from just five customers, whose usage ranges wildly from 20,000 to 70,000 MMBtu. She arbitrarily decided that for developing the rate, 60,000 MMBtu is an appropriate value for the annual usage. Rev. BEAR

Ex. 1.0, p. 9. There is no indication whether the 60,000 value is an arithmetic average or a median, or something else. She testified that there may be 85 other such customers, but knows only of, possibly, 15-20 in BEAR, and could name none. Tr. 241 (Smith).

Unable to define its own proposed rate class, BEAR retreats to criticism of AmerenCIPS, stating because it has assigned Standard Industrial Classification Codes ("SIC Code") to its customers, that AmerenCIPS should somehow be able to isolate this group of customers from others. BEAR concedes in its brief, however, that the SIC Code only shows the end use of AmerenCIPS' customers and that the utility does not rely upon them for setting rates, though they are still necessary for government reports. BEAR Init. Br., p.7. SIC Codes are not the answer: SIC Codes lack necessary size and usage information about the customers to design rates.

Moreover, there is no monitoring to ensure that the customer has not changed the nature of its operations. If the Company were required to develop a rate for a grain drying class, this type of monitoring or policing would be necessary to ensure proper rate application and would present an undue administrative burden on the Company.

Further, customers may engage in other business operations or uses of gas along with the grain dryer function. It is conceivable these customers also use gas in conjunction with their own residences or other facilities. Mr. Carls testified that grain dryers can be large river port operators or as small as single grain bins on family farms. Tr. 152 (Carls). Even BEAR's witness did not know if its members engaged in other activities. Tr. 242 (Smith). The use of gas by these customers may or may not be as BEAR surmises.

Lastly, BEAR erroneously contends that its proposal would have no adverse effect on other rate classes. BEAR Init. Br., p. 2. The cost of service study was done taking into account

Rate 3 customer characteristics. The cost allocation factors for this class were developed based on the class' characteristics. If Rate 3 is split, lower costs would be allocated to grain dryer customers, as BEAR proposes, and higher costs would be recovered from the remaining Rate 3 customers, as Ms. Smith admitted. Tr. 245 (Smith). If the remaining Rate 3 customers were not allocated the remaining costs, either there would be a revenue loss to AmerenCIPS (which, as a constitutional matter, AmerenCIPS need not accept), or the revenue loss could be made up equally from all other customers.

BEAR also notes that Illinois Power Company ("IP") has a grain dryer rate. BEAR Init. Br., p.8. Notably, BEAR does not point to any other Illinois gas utility that has a gas grain dryer rate. Moreover, the justification for the IP rate by the availability of an alternative fuel, propane, which is not a concern in this case. Tr. 243-44 (Smith).

5. Elimination of Interruptible Service

The Staff continues to recommend eliminating interruptible service. BEAR on the other hand argues for expansion of interruptible service.

The Staff has offered no compelling reasons to support its case. The only justification offered by Staff for eliminating the rate is that there have not been any interruptions in recent years. Staff has not considered the dollar impact by these customers taking interruptible service as opposed to firm. In contrast to Staff's belief, the record supports maintaining the status quo. Ameren Init. Br., pp. 116-17.

The ICC relies upon testimony from Staff witness Peter Lazare for the proposition that the appropriate foundation for ratemaking is cost of service, not customer impacts, in challenging Ameren's argument for keeping the rate. Staff Init. Br., pp. 104-05. Rate impacts should not be ignored completely. The Commission routinely considers customer impacts when designing rates, as the Staff well knows (and frequently advocates).

The Staff, curiously, does not deny that the system constraints articulated by Ameren witness Carls exist. Staff Init. Br., p. 105. The Staff notes simply that it has seen no engineering analysis to support Ameren's position. However, Ameren witness Carls who is intimately familiar with Ameren's gas system and its assets, testified there are, indeed, system constraints that are being met, in part, through the use of interruptible service to these limited number of customers. AmerenCIPS/UE Ex. 21.0, p. 3. There is no Staff evidence to the contrary.

6. Reduce Restrictions on Access to Interruptible Service

BEAR exhorts the Commission to direct Ameren to expand its interruptible service. BEAR Init. Br., pp. 12-13. BEAR promises various benefits if there is "interruptibility" for the entire system, primarily in reducing system costs such as those related to storage facilities, propane equipment, and so forth. BEAR Init. Br., p. 12. These facilities, however, largely relate to *supply*. The rates being set here are for *delivery*. BEAR asserts its members use little or no gas at time of peak, but somehow benefit the system by taking interruptible service in non-peak periods. This is nonsense. Taking the BEAR argument to its logical extreme, every customer should be offered an interruptible rate without fear of interruption. BEAR has no regard for the gas utility's responsibility to have in place a distribution system that meets the needs of customers each hour of the year.

BEAR argues that Ameren should take a long-term view of its capacity planning, and could avoid "system upgrades" with interruptible service. BEAR Init. Br., p. 13. This certainly would not be true for upgrades intended to address consumption at peak, if Ms. Smith is correct that her clients make no contribution to peak.

7. Elimination of Minimum Monthly Charges

8. Group Balancing Service

The only parties, aside from Ameren, to comment on Group Balancing Service were the Staff and MidAmerican. It appears there is complete agreement on this topic.

The Staff agreed with Ameren's proposal to first conduct workshops beginning this November and then file tariffs supporting a pilot program by July 1, 2004. The Staff also agreed the Commission need not decide any issues regarding specific terms and conditions, or fees to be charged, in this proceeding. Staff Int.Br. 106-108. MidAmerican is also in agreement with the workshop process, and proposed timeline whereby tariffs are filed on July 1, 2004, and in effect on September 1,2004. Like the Staff, MidAmerican desires that the issues or parameters regarding the service be resolved in workshops. MidAmerican Init. Br., p. 3.

9. Bank Balance Withdrawal Limit

MidAmerican continues to propose elimination of the 20% bank balance withdrawal limit. MidAmerican Init. Br., pp. 3-6. BEAR also submits very brief comments in support of modifying the 80% daily usage transport requirement. BEAR Init. Br., p. 15.

The Staff and the Ameren Companies had come to an understanding, that by revising the cost of service study so that fewer storage plant and related expenses were allocated to transportation customers and with the implementation of the Group Balancing Service, equity as between sales and transportation customers would be maintained and Group Balancing Service would serve to facilitate transportation customers' use of the system. Staff witness Charles Iannello agreed to AmerenCIPS' storage cost allocation in lieu of his recommendation to revise various rules governing the use of storage banks and deliveries in the Company's transportation tariff. Staff Init. Br., p. 86. Ameren Companies had also explained this in full in their Initial Brief. Ameren Init. Br., pp. 106-07. MidAmerican and BEAR continue to advocate for change, however.

MidAmerican clearly understands there has been a proposal to reallocate storage plant and related expenses to reflect a more limited access to storage that transportation customers receive. MidAmerican Init. Br., p. 4. MidAmerican does not challenge this revised cost of service study in any form. Instead, MidAmerican falls back on the *current* terms and conditions surrounding Rider T to make its case: "Under current terms of Rider T, however, transportation customers pay equally (relative to sales customers) for use of Companies' on-system storage assets, but are limited in that use . . . Companies unfairly restrict the use of banked gas to transportation customers under the pretext of maintaining equity between transportation and sales customers, despite transportation customers paying equally for the same assets utilized to manage the banking service. MidAmerican Init. Br., p. 5. Thus, on the one hand, MidAmerican acknowledges that transportation customers under the Ameren proposal, would be allocated less storage costs than will sales customers, but then asserts that transportation customers are paying equally for the same assets. MidAmerican then argues in the following paragraph that the change in rates will not encourage customers to participate in retail competition.

The facts are that transportation customers are paying less than sales customers for use of storage assets and, therefore, from a pure equity standpoint, should not enjoy the same usage of these assets. Properly set rates will not discourage meaningful competition. Delivery rates should not subsidize transportation customers.

Moreover, MidAmerican completely ignores or overlooks the implementation of the Group Balancing Service. While MidAmerican is quick to quote Mr. Ianello in certain instances, they apparently discard his belief that the Group Balancing Service will help to facilitate retail competition as these customers will be able to have their supplier group their accounts. Moreover, MidAmerican never comments on the various means by which transportation customers do manage their bank balances as testified to by Ameren witness Dottie Anderson. AmerenCIPS/UE Ex. 18.0, p. 8.

MidAmerican attempts to argue there is some weight to be given the correlation between the number of marketers in the retail gas business in the Ameren service territory with the implementation of the 20% bank withdrawal restriction. MidAmerican Init. Br., p. 6. Notably MidAmerican terms the correlation as a matter of coincidence, and does not attempt to link these facts. Nonetheless, there's no disputing that the 20% bank withdrawal restriction was put in place because transportation customers were utilizing the storage system in a way that was disadvantageous and inequitable to sales customers. They were gaming the system and using their bank in a manner to take advantage of changes in gas prices in the market. This resulted in sales customers having to pay more through the PGA. ICC Staff Ex. 5.0, pp. 13-14. As a result, the Ameren Companies pursued the subject tariff change which has been approved by the Commission. While MidAmerican complained that the agreed bank withdrawal restriction affects its marketing function, it never once attempts to explain why the original premise for the 20% bank withdrawal restriction is faulty.

BEAR similarly overlooks the reasons behind the implementation of the bank withdrawal restriction. BEAR states that AmerenCIPS "is not giving away cheap gas to its transportation customers," because of other charges that may be imposed or because AmerenCIPS may replace the gas the day it is taken, which price should be equal. BEAR Init. Br., p. 15. BEAR's simplistic understanding of the storage system undermines completely its position. Gas storage fields are not akin to a tub of water where one scoop of water can be taken and replaced immediately with a similar quantity. Storage fields are affected by a number of variables including pipeline constraints and deliveries not to mention the hour to hour change in usage of the storage assets that effect operational conditions and flexibility. While BEAR may believe that gas taken in a day can be replaced in that same day, and the price will always be the same, that is not an accurate portrayal of how a storage system operates.

Finally, despite BEAR's contention that AmerenCIPS is not giving away "cheap gas" to its transportation customers, the Commission believes differently. When the Commission approved the bank withdrawal restrictions, the Commission understood that transportation customers were realizing a benefit on the system for which they were not paying, and this benefit or flexibility was being paid by sales customers in the context of the PGA.

10. 80% of Daily Usage Transport Requirement

In their direct cases both the Staff and MidAmerican express concern with regard to the 20% daily withdrawal restriction on a transportation customer's storage bank. Staff witness Iannello had recommended replacing the requirement to deliver 80% of the customer's daily usage with the requirement to meet 100% of the customer's daily usage through bank withdrawal and/or deliveries to the Company's system. Staff Ex. 5.0, pp. 18-19. Similarly, MidAmerican witness Corey Jansen recommended that the storage bank restriction of 20% daily withdrawal of a customer's storage bank be liberalized. MidAmerican Ex. A , p. 3. These parties' concerns that gave rise to their recommendations have been alleviated, as explained below.

The Staff position was largely driven by the originally proposed allocation of a portion of storage plant and related expenses, suggesting that if transportation customers were being allocated these costs, they should enjoy additional storage related benefits. In its rebuttal and surrebuttal cases, Ameren agreed with Staff to reallocate storage plant and related expenses to reflect a more limited access to storage that transportation customers receive relative to sales customers. *See* AmerenCIPS/UE Ex. 32.0, p. 2. Staff viewed the reallocation of these costs as an alternative to its recommendations regarding changing the limitations on bank withdrawals, and expressed support for the Ameren approach. Rev. Staff Ex. 12.0, p. 10.

In addition to the revised cost of service study, Staff's changed view as to the propriety of removing the 20% bank withdrawal restriction was affected by Ameren's agreement to implement a Group Balancing Service. Staff witness Iannello testified through the Group Balancing Service, suppliers will have the opportunity to group customer accounts to facilitate meeting Ameren's delivery requirements and withdrawal limits. Rev. Staff Ex. 12.0, p. 11.

In spite of the changed cost of service study and agreement to implement a Group Balancing Service, MidAmerican continued to at least superficially support the elimination of the 20% bank withdrawal limit. In this respect, MidAmerican completely ignores that the changed cost of service study means that transportation customers will no longer pay equally for line-pack and on-system storage assets. AmerenCIPS/UE Ex. 32.0, pp. 3-4. Meaning, under MidAmerican's proposal, it would have transportation customers benefiting from a service for which they are not paying their fair share. In addition, as explained by Ameren witness Anderson, the 20% restriction on withdrawals is necessary in order to maintain equity between transportation and sales customers. If there was no 20% restriction in place and in the instance where Ameren is required to replace the gas withdrawn from the bank by transportation customers, the additional costs pertaining to same will be recovered through the PGA. It would be sales customers that pay these additional costs through the PGA. AmerenCIPS/UE Ex. 32.0, p. 4.

Notably, while MidAmerican is quick to offer a blanket tariff change that benefits its marketing function, it offered no quantitative cost analysis or usage analysis in support of its recommendation. Tr. 73 (Jansen). Moreover, MidAmerican witness Jansen agreed that the effect of its proposal could be detrimental to sales customers in the manner prescribed by Ameren witness Anderson. He agreed that Ameren would have less flexibility in using its on-system storage assets to serve its sales customers, and this would cause sales customers to incur additional gas supply costs. He had not given any consideration or provided any study to determine what cost impact there would be as a result of eliminating the 20% bank withdrawal restriction. Tr. 76 (Jansen).

MidAmerican's distorted view of gas utilities was highlighted in Mr. Jansen's cross-examination. While his argument in support of MidAmerican's recommendation was premised on the claim that other gas utilities did not impose the same restrictions, he admitted the assets of Northern Illinois Gas Company and MidAmerican were different than AmerenCIPS, and that he had not performed any study to compare the characteristics of those assets in order to validate his recommendation. Tr. 78-79 (Jansen).

11. Cash-Out Mechanism for Transportation Customers

BEAR continues to advocate that Ameren institute a cash-out mechanism for transportation customers. BEAR Init. Br., p.14. BEAR's arguments are essentially as follows: there's no cost to Ameren; transportation customers are paying for the storage assets to support their use of an unlimited bank; Ameren has the benefit of an unlimited bank and, therefore so should transportation customers; and, without a cash-out mechanism, the customer will not be able to use its gas even if paid for and in storage. The Ameren Companies have addressed the BEAR arguments in their brief. Ameren Init. Br., p.123. However, a brief reply is in order.

There is a cost at issue -- the cost to sales customers as explained by Ameren witness Anderson: "The Company's ability to manage its gas supply portfolio for the benefit of its sales customers is undermined by a cash-out mechanism when the transportation customers' volumes are cashed out during a period of high gas prices. The high prices are absorbed in the PGA and, consequently, sales customers pay more than they would have if the cash-out mechanism was not in place." AmerenCIPS/UE Ex. 18.0, p. 8. BEAR offered no rebuttal to this evidence.

In terms of the storage assets paid for by transportation customers, the record is abundantly clear that transportation customers are not paying for storage assets to the same degree or amount as are sales customers. Ameren Init. Br., pp.107-08; Staff Init. Br., pp.85-86. Therefore, the underlying premise for the BEAR position is without any foundation in fact.

As to Ameren's use of an unlimited bank, its use of storage assets for the benefit of sales customers ties directly to the cost of service issues addressed above. Sales customers pay more for these assets and, therefore, are entitled to use them in manner different than a group of customers who pay less. As Staff correctly notes, "No party opposed CIPS' proposed reallocation of storage plant and related expenses." Staff Init. Br., p. 86. Consequently, BEAR's end around ploy to receive a benefit without payment fills the den of inequity, and should be disregarded.

Finally, BEAR's assertion that its members will have excess gas absent a cash-out mechanism, completely ignores the record evidence. Ms. Anderson explained the current options available to transportation customers to address this situation which, again, were not challenged by BEAR. AmerenCIPS/UE Ex. 18.0, pp. 7-8.

12. 15-Day Requirement for New Services

Staff's Initial Brief provides absolutely no credible support for its proposal to require the Ameren Companies to amend their tariffs to install new service within 15 working days. Once again, in its Initial Brief, Staff continues to attempt to solve a problem that does not exist. Staff openly admits that there is no problem whatsoever with delays on the part of the Ameren Companies in installing new service, but continues to endorse a burdensome tariff requirement as a "proactive step" to ensure that service does not deteriorate in the future. Staff's Init. Br., pp. 112-13. Staff has done no analysis of the costs its proposal would create for the Company, which are explained in detail in Company witness Davis' surrebuttal testimony. AmerenCIPS/UE Ex. 24.0, p. 5. The Staff has provided no evidence of any factor that would suggest that a deterioration of service is likely for the Ameren Companies. The Staff has failed to explain why it would be fair or reasonable to apply this provision to the Ameren Companies when it does not apply to any of the other gas utilities in the state. Furthermore, the Staff witness sponsoring the recommendation has admitted that the proposed time limit for connecting new services (15 working days) is not based on the operations of the Ameren Companies. In short, Staff has utterly failed to provide any evidence that its proposal is necessary, cost-justified or fair, and therefore the proposal should be rejected.

Dated: August 8, 2003

Respectfully submitted,

CENTRAL ILLINOIS PUBLIC SERVICE COMPANY, d/b/a AmerenCIPS, and
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CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true and correct copy of the foregoing was served via electronic filing and electronic e-mail this 8th day of August, 2003, to the official service list in this matter.

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Christopher W. Flynn